BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A. Summary of Argument.

The primary legal issue raised by the present petition is whether or not the statutory freedom from personal liability for corporate debts which the shareholders of the constituent Liberty State Bank and Trust Company enjoyed at the time of the consolidation was destroyed by the voluntary consolidation of that title insurance and trust company with the Pennsylvania Bank and Trust Company, a state bank. If, as your petitioner maintains, the consolidation did not destroy or impair that valuable property right, then there can be no legal basis for the conclusion of the Supreme Court of Pennsylvania that your petitioner is now precluded from raising the federal question that his constitutional rights under the 14th Amendment have been impaired.

In order to establish that your petitioner did not knowingly and voluntarily assume a personal liability from which he had been previously absolved, when he entered of his own accord into a corporate consolidation between a solvent Pennsylvania title insurance and trust company with banking powers and a solvent Pennsylvania state bank with trust powers, this brief will first review the statutory and decision law of Pennsylvania governing the relative rights and liabilities of the constituent shareholders in the consolidated bank and trust company. That review will show the failure of the Supreme Court of Pennsylvania to recognize and apply certain controlling principles of the Pennsylvania law of corporate consolidation as well as its misapplication of certain other legal principles, sound in themselves but inapplicable to the particular facts and circumstances of the present case.

Having thus shown that your petitioner's freedom from individual responsibility for corporate debts survived the consolidation, this brief will set forth the several reasons why your petitioner has been deprived of a valuable property right and denied the equal protection of the laws in violation of the 14th Amendment.

B. The Supreme Court of Pennsylvania misapplied the statutory and decision law governing the relative rights and liabilities of constituent shareholders in a consolidated corporation.

The opinion by Mr. Justice Stern in the present case (353 Pa. 345; R. 51-55) and his opinion in the earlier case of **Freeman, etc. v. Hiznay, et al.**, 349 Pa. 89 (1944), are so inextricably interwoven that they actually form but a single decision upon the same subject matter. A full consideration of the later case requires a complete examination into the earlier case. For this reason the two interdependent opinions will be referred to and discussed in this brief.

The controlling principles of corporate law, which the Supreme Court of Pennsylvania correctly stated but misapplied, are (1) that at the time of the consolidation the shareholders of the constituent Pennsylvania Bank and Trust Company were individually responsible for its debts in the aggregate amount of $200,000. because of Section 5 of the Act of May 13, 1876, P. L. 161 (7 PS 71) under which that Bank was incorporated (349 Pa. 89, 92; 353 Pa. 345, 347, R. 52); (2) that the shareholders of Liberty State Bank and Trust Company were not individually responsible for its debts by reason of Section 24 of the Act of April 29, 1874, P. L. 73 (15 PS 1) under which that Title Insurance and Trust Company was organized (349 Pa. 89, 93; 353 Pa. 345, 347, R. 52); (3) that it was the general intendment of the Consolidation Act of May 3, 1909, P. L. 408 (15 PS 421) and of the Pennsylvania decisions dealing with the consolidation of corporations that "a consolidation does

not work any change in the assets, rights and liabilities of the constituent corporations or in the status of creditors and shareholders" (349 Pa. 89, 95); (4) that the statutory liability of the shareholders of the constituent Pennsylvania Bank and Trust Company, imposed by the 1876 Act and aggregating $200,000. at the time of the consolidation, continued for the benefit of the creditors of the consolidated corporation (349 Pa. 89, 95; 353 Pa. 345, 348, R. 52); and (5) that the consolidation could neither impair nor increase the total amount of that liability (349 Pa. 89, 95).

What perplexed the Supreme Court of Pennsylvania and led to its misapplication of the foregoing legal principles was whether the $200,000. statutory liability imposed by the 1876 Act should be wholly borne by the holders of the 8000 shares of the consolidated Pennsylvania Liberty Bank and Trust Company which were exchanged for their $200,000. of capital stock of the constituent Pennsylvania Bank and Trust Company, or whether it should be distributed equally and ratably among all of the holders of the 13,000 shares of the consolidated corporation (i. e., the 8000 shares distributed to the shareholders of the constituent Pennsylvania Bank and Trust Company and the 5000 shares exchanged for the stock of the constituent Liberty State Bank and Trust Company) (349 Pa. 89, 94). The Supreme Court of Pennsylvania concluded that this perplexing problem did not lend itself to solution by the application of any particular rules of logic but called rather for an answer dictated by practical consideration so far as consistent with legal principles (349 Pa. 89, 94).

After observing that the two constituent corporations are deemed to be dissolved and to lose their identity in the new consolidated corporate entity, and that it would be impracticable if not impossible to distinguish the 13,000 shares of the consolidated bank and trust company one from another, the Supreme Court of Pennsylvania decided that the $200,000. statutory liability should be divided equally and ratably among all of the holders of the 13,000

shares of the consolidated corporation because the latter's power to carry on a banking business after the consolidation was derived solely from the constituent Pennsylvania Bank and Trust Company by reason of the Act of 1876 (349 Pa. 89, 94-97).

There are several prejudicial errors underlying this unjust and improper result. First, it is violative of the legal principle that a consolidation under the law of Pennsylvania does not work any change in the rights and liabilities of the constituent corporations or in the status of their creditors and shareholders. The $200,000. statutory liability of the shareholders of the constituent Pennsylvania Bank and Trust Company has been changed and shifted so that their burden has been proportionately decreased and a new and heretofore non-existent liability has been imposed upon the shareholders of the constituent Liberty State Bank and Trust Company in derogation of their prior immunity. This change and shift in liabilities has materially altered the respective status of the two groups of constituent shareholders.

Second, the status of creditors has likewise been materially altered. Heretofore they looked only to the shareholders of the constituent Pennsylvania Bank and Trust Company for a stock assessment in satisfaction of their claims. Now they must look to a new group of shareholders for partial satisfaction of their claims, even though that group may not be as financially responsible as the original group.

Thirdly, the Supreme Court of Pennsylvania overlooked the statutory and decision law of Pennsylvania that the two constituent corporations continue in existence after the consolidation for the settlement of liabilities which are not merged and remain separate and apart. Section 3 of the Consolidation Act of May 3, 1909, P. L. 408 (15 PS 421) contains the proviso that "all rights of creditors . . . shall continue unimpaired . . . and the respective con-

stituent corporations may be deemed to be in existence to preserve the same." In the case of

FIDELITY & CASUALTY CO. v. AMERICAN SURETY CO., 313 Pa. 145 (1933)

the Supreme Court of Pennsylvania recognized that under Section 3 of the 1909 Consolidation Act the rights of creditors of the separate constituent corporations did not merge but remained apart and unimpaired. Chief Justice Frazer stated (p. 149):

> "Before the consolidation the Commonwealth stood in the position of a creditor of each original bank, with 'a sovereign right of priority over all other creditors'. After the merger, it remained a preferred creditor, with the right to pursue the property of each constituent corporation to the extent of its liability. The obligations of the sureties were fixed by their separate contracts before the merger and could be neither increased nor diminished by the agreement of consolidation to which they were not parties. As stated by the court below: '*While the merger generally worked the extinction of the corporate existence of each of the antecedent constituent banks, we think the legal existence of each constituent bank was in effect continued for settlement of liabilities as provided by the act of assembly . . .*' The obligations to the Commonwealth remained separate and distinct and there were consequently no merger of liability upon the part of the sureties giving right to cosuretyship." (Italics supplied.)

That the rights of creditors of the constituent corporations do not merge but remain separate after consolidation, and that the legal existence of each constituent corporation is continued for the settlement of liabilities, was also laid down and applied in the cases of **Mortgage B. & L. Assn.**, 334 Pa. 81 (1939), at pages 91-92 and **Electric Co. v. Transit Co.**, 258 Pa. 447 (1917). Both Mr. Justice Stern and counsel

for the Pennsylvania Banking Department recognized this limited survival of the constituent corporations, when in the **Hiznay** case (349 Pa. 89, 95) they refused to increase the individual liability of the shareholders of the consolidated corporation from $200,000., the aggregate par value of the capital stock of the constituent Pennsylvania Bank and Trust Company, to $325,000., the aggregate par value of the capital stock of the new consolidated corporation.

Fourthly, it is neither impracticable nor impossible to distinguish the 13,000 shares of the consolidated Pennsylvania Liberty Bank and Trust Company and to allocate the same between the respective shareholders of the two constituent corporations. The stock ledgers and transfer books should show to whom and in what amounts the 8,000 shares were issued and distributed in exchange for the 2,000 shares of the constituent Pennsylvania Bank and Trust Company and the 5,000 shares issued and distributed in exchange for the 5,000 shares of the constituent Liberty State Bank and Trust Company, and any subsequent changes in stock ownership. The consolidated corporation continued in active business from January 13, 1930, to September 21, 1931. The record does not disclose whether or not this stock was actively traded in during this short interval of time. In view of the then current business depression, the probability is that the other stockholders, like your petitioner, held on to their stock.

Finally, there is no basis at law or in equity for the equal and ratable division of the $200,000. statutory liability among all of the holders of the 13,000 shares of the consolidated corporation. The 1909 Consolidation Act does not impose or purport to impose any individual responsibility upon the shareholders which had not been in existence at the time of the consolidation. The Supreme Court of Pennsylvania has declared that it is the general intendment of the Consolidation Act and of the decisions thereunder that the consolidation does not effect any change in

the rights and liabilities of the constituent corporations or in the status of their creditors and shareholders. It would be unfair and inequitable to impair and destroy the freedom from individual responsibility of the shareholders of the constituent Liberty State Bank and Trust Company, who gained nothing by the consolidation because their constituent company already possessed full banking powers before the consolidation. As pointed out by the Supreme Court of Pennsylvania in the **Hiznay** case (349 Pa. 89, 93) this freedom from liability was not affected by the subsequent grant of banking powers to the constituent title insurance and trust company, which still remained a title insurance and trust company and did not become a banking institution subject to the provisions of the Banking Act of May 13, 1876, P. L. 161 (7 PS 71) when it acquired banking powers under the enabling Act of May 9, 1889, P. L. 159 and its amendments and supplements, including the Act of May 9, 1923, P. L. 173. See **Gordon v. Winneberger,** 310 Pa. 362 (1932) at pages 370-74.

The Supreme Court of Pennsylvania in the present case (353 Pa. 345, 348; R. 53) corrected the prior erroneous statement made in the **Hiznay** case (349 Pa. 89, 93) to the effect that the power of the new consolidated corporation to carry on the business of banking was derived solely from the constituent Pennsylvania Bank and Trust Company by reason of the Act of 1876, and admitted that this power was jointly derived from both constituent companies by reason of the Banking Act of 1876, under which the constituent Pennsylvania Bank and Trust Company was organized, and the enabling Act of May 9, 1889, P. L. 159 and its amendments and supplements, including the Act of May 9, 1923, P. L. 173 which enlarged the rights and powers of title insurance and trust companies in Pennsylvania and granted them full banking powers provided they, like the constituent Liberty State Bank and Trust Company, had accepted the provisions of such enabling legislation after their incorporation under the Act of 1874. In an effort to explain away the damaging

effect of this admission and to justify the impairment and destruction of the freedom from individual responsibility previously enjoyed by the shareholders of the constituent Liberty State Bank and Trust Company, the Supreme Court of Pennsylvania (353 Pa. 345, 348-49; R. 53-54) argues that the business of the consolidated corporation was carried on by all the shareholders acting under the two Acts of 1874 and 1876 jointly and for their combined benefit and that, therefore, all the shareholders inherited indiscriminately and in common all the rights granted by both statutes subject to the liabilities and restrictions imposed by both statutes. Such an argument contravenes the statutory and decision law of Pennsylvania that the consolidation did not alter the rights and liabilities of the constituent corporations or the status of their creditors and shareholders. If this argument be sound, then the Supreme Court of Pennsylvania as well as counsel for the State Banking Department were in error when they agreed in the **Hixnay** case (349 Pa. 89, 95) that the $200,000. of liability could under no circumstance be increased to $325,000. If the shareholders of the constituent Liberty State Bank and Trust Company could exercise full banking powers before consolidation without individual responsibility for corporate debts, and if such banking powers survived and were not impaired by the consolidation, certainly they cannot be impaired and made subservient to the co-existent banking powers derived from the other constituent corporation.

Your petitioner does not dispute the statutory and decision law of Pennsylvania that the double liability of the shareholders of the constituent Pennsylvania Bank and Trust Company continued unimpaired after the consolidation. He does object, however, to the changing of that liability by the Pennsylvania Supreme Court through enlarging the group of shareholders, thereby cutting down the liability of the shareholders of the constituent Pennsylvania Bank and Trust Company and placing a portion of their liability upon the shareholders of the constituent Liberty

State Bank and Trust Company without legislative authority and without any resultant benefit or gain to those shareholders who have previously enjoyed freedom from individual responsibility. If any such change is to be made in the law of Pennsylvania, it should be effected by legislation and not by judicial fiat.

C. The imposition of personal liability upon the shareholders of the constituent title insurance and trust company constitutes a taking of property without due process of law and a denial of the equal protection of the law in violation of the 14th Amendment to the Constitution of the United States.

At no stage of the present proceedings has it been contended that the statutory exemption from personal liability for corporate debts was not a valuable property right entitled to full protection under the 14th Amendment. Mr. Justice Linn in **Gordon v. Winneberger**, 310 Pa. 362 (1932), referring to the immunity of shareholders in a title insurance and trust company under Section 24 of the Act of April 29, 1874, P. L. 73 (15 PS 1) even though the company, as here, had acquired banking powers under the Act of May 9, 1923, P. L. 173, said (pp. 367, 370-71, 373):

> "The general rule is that a shareholder's liability for corporate debts is limited to the amount he agreed to contribute to the capital stock. Enlarged liability is the exception; it possesses elements of a penalty. Section 24 shows that the legislature was not content to rest the stockholders' obligation on the implications of the general rule and, therefore, specifically expressed the immunity. *It is a valuable privilege. A legislative intention to withdraw it should clearly appear before the courts may declare it withdrawn.* In O'Reilly v. Bard, 105 Pa. 569, 573, we said: 'Corporation stockholders, who have already contributed their proportions to the capital stock, are not at the common law,

or in equity, liable for corporate debts; statutes which impose this liability must therefore be strictly construed; this rule of law is well settled: Mean's App. 85 Pa. 78.' . . .

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"Is defendant liable under section 5 of the Banking Act of 1876? It is clear that in the general acts providing, on the one hand, for the formation of corporations with the powers specified in section 2, clause 9 and section 29 of the general corporation act, and supplements, and, on the other hand, for banks of discount and deposit under the Act of 1876, *the legislature kept separate and apart the classes of corporations to be formed under each.* Article XVI, section 11, of the Constitution, required that banking corporations be kept in a separate class. . . .

"In our decisions referring to the subject, we have necessarily observed and adhered to the classification so established. The separation has been maintained with all its implications although the corporations receive deposits of money, and (in the last case) also discounted paper. . . .

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"Unless, therefore, such trust companies be transferred from the class of title insurance companies, formed under the Corporation Act of 1874, to 'the class to which banking institutions belong', the immunity created by Section 24, supra, cannot be displaced by the claim of enlarged liability imposed by section 5. *If such change in classification, with the resulting burden, should be made, it must be made by the legislature, not by the court.* If the change had been intended by the statutes granting additional powers to companies formed under the Corporation Act of 1874, the legislature would have used appropriate words to declare the intention; in the absence of such declaration, we must conclude that the change was not intended." (Italics supplied.)

The decision of the Supreme Court of Pennsylvania in both the present case (353 Pa. 345, 1946) and the **Hizmay** case (349 Pa. 89, 1944) necessarily results in taking the money to be paid by your petitioner and the other shareholders in the constituent Liberty State Bank and Trust Company under the stock assessment and giving it not only to the creditors of the new consolidated corporation and of the constituent Pennsylvania Bank and Trust Company, but also to the creditors of the constituent Liberty State Bank and Trust Company from whom he and they were expressly immunized by the Act of 1874. This judicial action clearly violates the due process of law of the 14th Amendment.

The **Winneberger** case, supra, also holds that a bank incorporated under the Pennsylvania Act of May 13, 1876, P. L. 161 (7 PS 71) may never acquire title insurance powers even though it has been granted trust powers under the Pennsylvania Act of July 17, 1919, P. L. 32. The power of the consolidated corporation to conduct the business of a title insurance company, as it actually did, was consequently derived solely from the constituent Liberty State Bank and Trust Company.

The imposition and collection of a stock assessment upon the shareholders of the Liberty State Bank and Trust Company is a violation of the equal protection of the law afforded by the 14th Amendment in that they are denied the immunity granted under Section 24 of the 1874 Act. In other words, shareholders of those title insurance companies, which have not merged with banks organized and operating under the Act of 1876, receive the benefit of the immunity expressly provided by Section 24; whereas those shareholders, like your petitioner, whose title insurance company joined with a bank incorporated under the Act of 1876 are deprived of this express statutory protection. This unequal treatment is forbidden by the 14th Amendment.

D. The shareholders of the constituent title insurance and trust company are not barred from claiming their statutory exemption from individual responsibility by their assent to the consolidation.

There is no factual or legal basis for the statement by the Supreme Court of Pennsylvania that your petitioner knew or under the law was bound to know that he had assumed a personal liability from which he had been previously absolved when he entered, of his own accord, into the consolidation (353 Pa. 345, 349; R. 54). The Consolidation Act of May 3, 1909, P. L. 408 (15 PS 421) does not impose, expressly or by necessary implication, any individual responsibility upon the stockholders of the consolidated corporation. On the contrary, Section 3 of that Act expressly provides that all rights and privileges shall continue and vest in the consolidated corporation and preserves without change the status of creditors and shareholders. The Courts of Pennsylvania have likewise held that consolidation works no change in the rights and liabilities of the constituent corporations or in the status of creditors and shareholders. Patently, there was nothing to put your petitioner and the other shareholders in the constituent Liberty State Bank and Trust Company on notice that they were assuming a new liability and abandoning their prior immunity.

Both constituent corporations were solvent at the time of their consolidation. The creditors of both accepted the consolidated corporation as their debtor and continued to transact business with it. There could be no possible misleading of creditors to their damage to justify an estoppel against the shareholders of the constituent title insurance and trust company.

Prior to the decision of the Supreme Court of Pennsylvania in the **Hiznay** case (349 Pa. 89, 1944) there had been no reported case in Pennsylvania involving the relative rights and liabilities of shareholders in a new corporation arising from the consolidation of a solvent state bank with trust powers and a solvent title insurance and trust company

with banking powers. The first time that the Legislature of Pennsylvania expressly continued the liabilities of shareholders in merging or consolidating corporations was the Act of May 5, 1933, P. L. 364 (15 PS 2852-907), which Act postdates the January 13, 1930 consolidation in the present case. Under these circumstances it cannot be stated as a matter of fact or law that your petitioner knew or was bound to know that he was surrendering his immunity from individual responsibility when he assented to the consolidation.

It has been heretofore pointed out (pp. 2, 17-18 ante) that the constituent Liberty State Bank and Trust Company possessed full banking powers in addition to its original grant of the powers of a title insurance and trust company. Mr. Justice Stern admits in his second opinion (353 Pa. 345, 348; R. 53) that the power of the new consolidated corporation to carry on the business of banking was derived from both constituent corporations. Your petitioner and the other shareholders of the constituent Liberty State Bank and Trust Company did not, therefore, receive any additional benefit from the consolidation which they had not previously enjoyed. An estoppel may not be raised against them on the basis of benefits received, as Mr. Justice Stern attempted to do in his first opinion (349 Pa. 89) but frankly admitted was erroneous in his second opinion (353 Pa. 345, 348; R. 53).

It is significant that it stands admitted that if the Secretary of Banking had applied all of the assets received by the new consolidated bank from the constituent Pennsylvania Bank and Trust Company in payment of the depositors of that constituent, they would have been paid in full (R. 37-38). It is also conceded by the Secretary of Banking that if the assets on hand on January 9, 1937 (the date of the levy of the stock assessment), which had been received from the constituent Pennsylvania Bank and Trust Company had been applied to the payment of the depositors of that constituent, they would have been paid in full (R. 38). Had the assets been so applied, there would be no

creditors of the constituent Pennsylvania Bank and Trust Company for whose protection any assessment would have been necessary. Under these circumstances it might well be argued that an estoppel would lie against the Secretary of Banking for his failure to act in the protection of that group of creditors for whose benefit a stock assessment could alone be levied and collected.

In closing it should be noted that the present petition for certiorari does not ask this Court to reverse the construction placed upon the statutory law of Pennsylvania by the Supreme Court of Pennsylvania. What it seeks is a reversal based upon the failure of the Supreme Court of Pennsylvania to apply to the particular facts of the present case the controlling principles of statutory and decision law regarding the consolidation of corporations and the relative rights and liabilities of their shareholders.

E. Conclusion.

For the reasons above stated, it is respectfully submitted that the present case is one calling for the exercise by this Court of its supervisory powers over a federal question of substance and it is therefore respectfully requested that a writ of certiorari should be granted to review the decision of the Supreme Court of Pennsylvania in the present case, and finally to reverse it.

Respectfully submitted,

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